ASP GUIDANCE NOTES (GN2015-2)

Implementation Guidelines of Non-Life Reserve Valuation Standards

In accordance with the IC Circular Letter 2015-32

(August, 2015)

Non-Life Insurance Committee

Actuarial Society of the Philippines

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Introduction

The Actuarial Society of the Philippines (ASP) affirms that the IC Circular Letter 2015-32, Valuation Standards for Non-Life Insurance Policy Reserves, presents a sufficient framework of standards for the valuation of non-life insurance policy reserves (or statutory reserves) for regulatory reporting to the Insurance Commission.

The ASP also recognizes that regulatory reporting is primarily for establishing and monitoring of the solvency of non-life insurance and professional reinsurance companies. The statutory reserves represent the measure of the company's main liability on direct or assumed inforce policies as at the valuation date. Risk based capital (RBC), which is an allocation of surplus or net worth, shall be layered on top of the statutory reserves for adequate provisions for solvency.

Guidance Notes

The ASP issues these Guidance Notes (GN2015-2) for compliance of all Fellows and Associates, accredited by the Insurance Commission as Non-Life Actuary, certifying the basis, calculations and amounts of non-life policy reserves in accordance with IC Circular Letter 2015-32.

Scope

1. DATA – validation, classification and grouping
2. VALUATION METHODOLOGIES
3. MARGIN FOR ADVERSE DEVIATION
4. DISCOUNTING
5. REPORTING

1. DATA

IC Circular Letter 2015-32, Section 4: Data and Systems

Guidance Note: The accredited Non-Life Actuary shall use the premiums and claims data which is, to his guided judgment, most appropriate to calculate the applicable policy reserves.

- The accredited Non-Life Actuary shall be satisfied with the accuracy and completeness of the data, performing checks and tests to ascertain data integrity and completeness. The accredited Non-Life Actuary shall perform the following: check consistency with financial statement reports, compare with data for prior periods, conduct data trend reasonableness checks and ensure consistency of data definitions (e.g., date of loss, date reported, date paid, claim status, date closed, date reopened).

- Although the company is required to maintain a historical claims database of at least ten (10) years, the accredited Non-Life Actuary may choose to use data fewer than the 10-year historical claims database. However, it is the responsibility of the accredited Non-Life Actuary to provide acceptable justification of such choice.

- If the company's systems and resources permit, the accredited Non-Life Actuary may choose to classify data into groupings that are more granular than the minimum requirement of IC. For example:
  - Fire can be further broken down into Fire/Lightning, Earthquake, Typhoon, Flood, etc.
  - Marine can be further broken down into Hull and Cargo.
  - Motor Car can be further broken down into Compulsory and Voluntary.
  - Other classes like Aviation, Travel, Accident & Health, etc. can be shown separately.
  - For classes with reinsurance acceptances, Direct and Inward Reinsurance business can be shown separately.

  The accredited Non-Life Actuary's aim should be to divide the data into sufficiently homogeneous groupings, maintaining the credibility of the amount of each grouping.

- Aside from separating the large loss events for the purpose of measuring and monitoring catastrophic risks, the accredited Non-Life Actuary may choose to further break down data, if the company's systems and resources permit, into regular/attritional losses and large losses not pertaining to catastrophic events. If the accredited Non-Life Actuary so chooses, he must maintain the consistent definition of the types of losses.

- The accredited Non-Life Actuary must be consistent in choosing whether to group data by accident year or by underwriting year. Accident year is usually used by direct writing non-life companies while reinsurance companies use underwriting year.

2. VALUATION METHODOLOGY for INCURRED BUT NOT REPORTED (IBNR)

IC Circular Letter 2015-32, Section 8.3 to 8.5: Losses & Claims Payable

Guidance Note: The accredited Non-Life Actuary shall use the most appropriate methodology for calculation of the IBNR, Incurred But Not Enough Reported (IBNER) and Loss Adjustment Expenses (LAE) for each data class.

- Although the IC Circular mentioned three valuation methodologies, namely, chain ladder method, expected loss ratio method and Bornhuetter-Ferguson method, for the estimation of the IBNR, it is highly recommended that the accredited Non-Life Actuary look into other methodologies that may be more appropriate.

- The accredited Non-Life Actuary may refer to the following table that summarizes typical valuation methodologies used for different levels of assessed risk and different business lines.

	Standard Risks High Frequency-Low Severity	Severe Risks Medium Frequency-Medium Severity	Catastrophic Risks Low Frequency – High/Medium Severity
Business Lines	Motor – Damage Marine - Cargo Typhoon Flood Travel, Accident & Health	Engineering Casualty Personal Liability Fire Motor Bodily Injury	Earthquake Marine – Hull
Methodology	- Case-by-case reserves - Chain Ladder - Bornhuetter-Ferguson - Average Cost per Claim (Frequency Severity Techniques)	- Case-by-case reserves - Severity Modelling - Expected Loss Ratio approach	- Case-by-case reserves - Exposure-Based approach (using probable maximum loss – PML) - Scenario Analysis

The accredited Non-Life Actuary may refer to the Casualty Actuarial Society Notes: "Estimated Unpaid Claims Using Basic Techniques" by Jacqueline Friedland, FCAS, FCIA, MAAA, FCA, KPMG LLP.

3. MARGIN FOR ADVERSE DEVIATION

IC Circular Letter 2015-32, Section 9: Margin for Adverse Deviation

Guidance Note: It is up to the judgment of the accredited Non-Life Actuary to determine the basis and provision to achieve the required level of sufficiency for the establishment of the Margin for Adverse Deviation (MfAD), with due consideration for the requirements of the Insurance Commission.

In estimating MfAD by class of business, the accredited Non-Life Actuary may, if deemed appropriate, refer to published industry research or other suitable benchmarks.

4. DISCOUNTING

IC Circular Letter 2015-32, Section 10: Discounting

Guidance Note: Should the accredited Non-Life Actuary find the need to discount cash flows due to materially long finalization of claims, the discount rates to be used shall be obtained from the schedule of Peso and Dollar spot and forward rates provided by the Insurance Commission.

5. REPORTING

IC Circular Letter 2015-32 Annex A, Report on the Actuarial Valuation of Non-Life Insurance Policy Reserves

Guidance Note: The accredited Non-Life Actuary is responsible for the demonstration of:

A. The impact on Policy Reserves due to changes in:
    a. The insurance policy portfolio over the relevant reporting period,
    b. Valuation methodology,
    c. Best-estimate assumptions,
    d. Margin for Adverse Deviation,
    e. Market-consistent parameters,
    f. Business models and nature of contractual obligations,

B. Components of Policy Reserves that may be utilized for financial reporting under PFRS and other local regulations

The accredited Non-Life Actuary should present by class of business the following components of Policy Reserves laid out below:

Premium Liabilities	Unearned Premium Reserves (UPR)
	Unexpired Risk Reserves (URR)
	Margin for Adverse Deviation (MfAD) on URR
Losses and Claims Payable	Outstanding Claims
	Incurred But Not Reported (IBNR) Claims
	Incurred But Not Enough Reported (IBNER) Claims, if not included under IBNR
	Loss Adjustment Expenses Payable
	Margin for Adverse Deviation (MfAD) on Claims and Expenses

The accredited Non-Life Actuary may further break down Outstanding Claims into Due and Unpaid, In Course of Settlement and Resisted Claims.

During the transition period up to the date of adoption of the new valuation standards, the accredited Non-Life Actuary should present the following reserve amounts:

	As of End of Prior Period	**As of End of Current Period**	**Increase/ Decrease**
[A] Premium Liabilities based on OLD valuation standards			
[B] Premium Liabilities based on NEW valuation standards			
[A] – [B]			
[C] Losses and Claims Payable based on OLD valuation standards			
[D] Losses and Claims Payable based on NEW valuation standards			
[C] – D]			

During and beyond the transition period, the accredited Non-Life Actuary should present the following reserve amounts:

	As of End of Prior Period	As of End of Current Period			
		Prior to any change in assumptions	Increase/ Decrease	After any change in assumptions	Increase/ Decrease
[A] Unearned Premium Reserves (UPR)					
[B] Unexpired Risk Reserves (URR)					
[C] MfAD on URR					
[D] Excess of {**[B]** + **[C]**} over **[A]**					
[E] = [A] + [D] Premium Liabilities					
[F] Outstanding Claims					
[G] IBNR Claims					
[H] IBNER Claims, if not included under IBNR					
[I] Loss Adjustment Expenses Payable					
[J] MfAD on Claims and Expenses					
[K] = [F]+[G]+[H]+[I]+[J] Losses and Claims Payable					
[L] = [E] + [K] Policy Reserves					

During and beyond the transition period, the accredited Non-Life Actuary should conduct backtesting of the IBNR. The length of the backtest period shall be determined by the accredited Non-Life Actuary using his best judgment.

The results of the IBNR backtesting should be presented in the following format:

Backtesting of IBNR as of 12/31/X+1

			As of Valuation Date 12/31/X+1	
Line of Business	IBNR Method	IBNR as of 12/31/X (a)	Actual Approved Claims Incurred Prior to, but reported after 12/31/X (b)	Adequacy Ratio = (a)/(b)
Fire				
Marine				
Motor Car				
Casualty				
Suretyship				
Other Lines				
Total				

			As of Valuation Date 12/31/X+1	
Line of Business	IBNR Method	IBNR as of 12/31/X-1	Actual Approved Claims Incurred Prior to, but reported after 12/31/X-1 (b)	Adequacy Ratio = (a)/(b)
Fire				
Marine				
Motor Car				
Casualty				
Suretyship				
Other Lines				
Total				

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